KPMG Economics

Insights from the Emerald Isle
On tour with economists abroad

Diane C. Swonk, Chief Economist
KPMG US
July 21, 2025

Each July I meet with more than 25 economists and policymakers from around the world, representing almost as many countries. Our meetings are strictly Chatham House rules, which means I cannot quote anyone directly, but I can share what I learned. This year's meeting was in Ireland, a poignant backdrop for our deliberations.

A visit to the Cliffs of Moher provided an apt metaphor for the unraveling economic integration and cooperation of the post-WWII era. They trace a giant continental ledge, where the solid ground of international cooperation meets the churning uncertainty of a fragmenting world order.

The treacherous path is shorter this year. Barriers were erected to stop people from getting too close to the edge. A tombstone buttressed a stone bench memorializing those who lost their lives.

The closer we get to the edge of a full-blown trade war, the greater the risk of misstep. A full decoupling is not probable but possible with some of our trading partners.

The face of the cliffs rapidly changes, with large parts of the limestone tumbling into the sea. That mirrors trade negotiations, as the goal posts keep shifting.

The willingness to break existing trade agreements with Canada, Mexico, Japan and South Korea has further eroded trust. What weight would future agreements hold if existing ones can be discarded with the stroke of a pen?

Retaliation by our counterparts has been restrained but that could change. Those who have pushed back against the US president have gained in popularity with their electorates.

Economy whipsawed by front-running

Real GDP is expected to come in at a 2.4% pace in the second quarter, a sharp rebound from the 0.5% contraction of the first quarter. The second quarter is a bit of a mirror image of the first quarter, with the trade deficit narrowing after the front-running we saw ahead of tariffs and inventories liquidating, which accounts for the rebound in real GDP. Consumer spending was positive but subdued while housing activity lost further ground. Business investment and government spending picked up, but gains will be short-lived.

Growth is expected to average less than 1% in the first half of the year; annual growth is expected to come in at 1.4%. Higher costs associated with tariffs simultaneously erode purchasing power and cut into profits. That is already showing up as a bump in goods prices and will soon show up as a headwind to employment. The Atlanta Fed estimates that those effects could cost 1.2 million jobs, most outside of Washington, DC.

Business investment is expected to weaken except for investment in AI infrastructure. The tech behemoths are in a bidding war for top AI talent. Inventories will drain, while the trade deficit continues to narrow. The cost of tariffs is expected to weigh more heavily on imports than exports. Government spending is forecast to barely budge in the second half. The exceptions are spending on Customs and Border Protection and that for retirees. The ranks of those collecting Social Security and Medicare swelled, as younger baby boomers rushed to tap their benefits early to avoid losing them later.

The Fed eventually cuts. The Fed is holding off on rate cuts until it can better assess the full effects of tariffs on inflation. A weaker labor market is expected to provide that opening by year-end. One challenge is the resumption of at least a portion of the tariffs announced on April 2, which makes it harder for the Fed to look through any increase in inflation as a one-and-done phenomenon. The first cut in rates is still penciled in for December, but uncertainty is high. Governor Christopher Waller has already made clear that he intends to dissent in favor of a cut at the July meeting; he is more worried about the blow to demand than the boost to inflation associated with tariffs.

Prime Minister Mark Carney of Canada won a surprise victory against his opponent after pushing back on tariffs. President Luiz Inácio Lula da Silva of Brazil saw a bump in the polls when he refused to capitulate to avoid 50% tariffs. Europe is prepping for retaliation.

This special edition of *Economic Compass* provides a summary of what I learned and how those factors are reshaping the outlook for growth across regions. Tariffs have exacerbated fissures between the US and its closest trading partners.

The rest of the world is not standing still. They are solidifying bonds with each other and moving forward on trade without us. Those shifts and threats to the independence of the Federal Reserve could make us more susceptible to inflation shocks or worse, stagflation - a toxic mix of rising prices and unemployment.

Global roundup

The global economy is expected to slow in 2025 and 2026, with one participant at our meeting forecasting a global recession. The on-off saga of tariffs has created the mother of all front-running cycles.

There was considerable debate about the nonlinear nature of tariffs and trade wars. It could take years to see the full effects. Even then, damages may only be clear in hindsight. Brexit and the delayed blow to US manufacturing employment associated with the 2018-19 trade war are examples.

Headwinds are gaining speed, as front-loading borrows from economic activity later in the year. Cuts to the federal workforce, the collateral damage that will trigger and layoffs due to a blow to profits from tariffs suggest downside risks are mounting in the US.

Some of the largest negative effects of tariffs were delayed by the pause of the most prohibitive tariffs. Those shifts and other mitigation strategies delayed and dampened the initial impact of tariffs. However, there are signs we are hitting a tipping point - prices of some of the most tariff-sensitive goods jumped in June.

Increased spending on defense among our NATO allies will provide an extra boost to their growth, along with easier monetary policy. Concerns about government debt across many of our closest geopolitical allies have faded. Emerging markets face greater debt problems, as does the US.

The dollar's reserve currency status was debated. Most agreed that there is still no substitute. However, dents in our armor are emerging.

Transactions outside of dollar-denominated clearing systems are small but accelerating. Russia's invasion of Ukraine and the sanctions that followed prompted central banks to diversify away from dollar holdings. The BRICS – Brazil, Russia, India, China and South Africa - have been among the most aggressive.

Those shifts and the push by the US to create more hurdles to trade undermine demand for the greenback. A more consequential depreciation in the dollar is likely. That would amplify the inflation resulting from tariffs. Hence, the Fed's reticence to cut before the full extent of the inflationary shocks are known.

The Treasury bond market is losing its luster as a "safe haven." Foreign demand has waned, which is creating a floor under long-term bond yields. Overt threats to the Fed's independence are further spooking investors.

The eurozone looks primed to move forward on a Eurobond issuance. It would take some time and a lot of reforms to achieve the status needed to compete with Treasuries; even a distant threat from the eurozone to the supremacy of the Treasury bond was once unimaginable.

The European Central Bank (ECB) supports issuing Eurobonds, even if the initial issuance is small. A convergence on bond yields across the region makes the timing ripe to do so. I heard more than once that the US has prompted Europe to do what it should have done a long time ago.

Most major central banks have cut rates and intend to do more. Brazil, Japan and the US are outliers.

Recession risks moved up compared to a year ago but are not the baseline for most countries. Some cracks are forming but are not widespread. Japan, whose producers have absorbed more of the blow from tariffs in profit margins, has started to contract.

The greatest threats to the outlook are trade wars. The largest opportunity is AI. The payoffs will take time but provide an offset to inflationary shocks, notably in the US.

"A more consequential depreciation in the dollar is likely. That would amplify the inflation resulting from tariffs."

The challenge is that the benefits of AI are likely to accrue more to the owners of capital than workers. That worsens income and wealth inequalities, which tends to dampen growth and raise the risk of asset bubbles. (See Structural Change Watchlist.)

Many countries are looking to fill the void left by the US with trade agreements of their own. The European Union is working to join Mercosur, its Latin American equivalent. That would create a common market of 790 million people, accounting for nearly 25% of global GDP. Canada will likely join as well.

Most economists at the meeting viewed the politics within their own countries as more populist, a trend that has been rising for some time. That is unwelcome news, as it sets the stage for more protectionism which is grounded in ideology more than economics.

Regional breakdown

North America

Growth in North America is poised to slow. The **US** will absorb the bulk of the rise in costs due to tariffs, which dampens profits and erodes purchasing power. The effective tariff rate could easily top 20% before year-end from below 3% at the start of the year. A mild bout of stagflation erupts but a recession is averted.

Canada and **Mexico** are experiencing the other side of that trade via a blow to demand. Our colleague from Canada was more optimistic than many forecasters about his country's prospects. Fiscal stimulus and rate cuts are the main reasons, but he still expects growth to slow dramatically and unemployment to rise.

Our Mexican colleague was less sanguine. Mexico is expected to barely grow in 2025, with risks highly dependent upon where tariffs land. That has left the Bank of Mexico leaning toward more rate cuts.

The wildcard is the United States Mexico and Canada Agreement (USMCA), which is slated to be renegotiated in 2026. A failure to approve the agreement could trigger its sunset clause.

The most likely scenario is that we "muddle through," and sign a more restrictive form of the trade agreement. A full break could be catastrophic, especially for the vehicle industry, whose supply chain crosses the borders of the three countries multiple times.

Mexico has the most free-trade agreements of any country. Many manufacturers are looking to leverage it as a launchpad to exports as opposed to the US.

Europe

The **UK** could get a lift from the easing of trade tensions due to the deal it cut with the US. The headwind is fiscal policy, which is now restrictive. Inflation has cooled and the Bank of England has signaled a greater willingness to cut further.

Growth in the **Eurozone** remains subdued but has held up better than expected. Tariffs are less of a direct threat to the region than the uncertainty they trigger. The region is expected to perform about as well as it did in 2025, with rate cuts partially offsetting the drag of tariffs and the uncertainty they have stoked.

The ECB is poised to cut rates further, while efforts to shore up the green transition and defense spending are expected to boost government outlays. Debts and deficits are less of a concern, with Germany leading the way.

The economies of **Central and Southeastern Europe** were described as "the less sunny side of Europe." Economic convergence with higher income economies has stagnated.

Many economies in the region are slipping into what is known as the "middle income trap." As emerging markets grow, they often lose their competitive advantage, which prevents them from reaching the per capita incomes of more developed economies.

A rebuilding of Ukraine? The White House's recent pivot to support for Ukraine is a welcome development, but skepticism on a sustained ceasefire is high. Rebuilding will require large-scale infrastructure, energy and military projects.

Large European countries will need to help, along with the US. The mining of rare earths is more of a long-term than short-term proposition. Concerns about corruption and institutional stability are intensifying.

Developed Asia

Japan is slipping into recession, with tariffs taking a bite out of exports. Stagflation is a risk, given the depreciation in the yen and high food costs: Rice has risen dramatically this year.

The Bank of Japan plans to hold rates steady and wait for a weakening economy to do the heavy lifting on inflation. Confidence in the Bank of Japan's strategies was the lowest among developed economies.

The ruling government in Japan lost its recent election. That throws a monkey wrench into current trade negotiations, which were already tenuous.

South Korea is suffering from weak construction activity. The blow from higher tariffs on vehicles will add insult to injury.

The Bank of Korea cut again in May; at least one more cut rates is expected this year.

Emerging Asia

The front-running of tariffs helped to buoy much of Asia at the start of the year but borrowed from the second half. **China** was one of the largest beneficiaries.

China faces many challenges, which have left the People's Bank of China weighing how to stimulate. The country is flirting with deflation, but lower rates could spur investment in new plants instead of consumer spending. That would add to excess capacity problems.

The US and China are competing for who dominates trade relationships in the region. The US is attempting to isolate China. One way to do that is to tariff China's inputs at higher rates. That is difficult to enforce and would wipe out much of **Vietnam's** advantage in the region.

Malaysia, Taiwan and **Singapore** saw a surge in demand due to the front-loading associated with computer chips. That will borrow from growth later in the year. Tariffs on semiconductors and their derivatives, such as smart phones, are due any day.

India garnered a lot of debate. The fear is that it will fall short of the hype. Structural hurdles are large, with no way to scale manufacturing – a key ingredient to bringing broader based economic gains. Its corner on the market for AI talent is a plus, but it's hard to fully tap into given gaps in the energy grid. Unbearable heat waves are on the rise, further stressing the energy grid.

Australia

Australia is the most exposed to the trade war between the US and China via its commodity exports. The country has seen a surge in its population, although not as dramatic as Canada or New Zealand. Household finances have been pinched but are easing. Housing affordability has deteriorated markedly, which is seeding social and political backlash.

Inflation has come down, without a major rise in unemployment. The Reserve Bank of Australia was slower to raise rates than many of its counterparts; another cut is expected this year.

Australia is one of a handful of countries with a AAA credit rating on its debt. That could change this year in response to a rise in debt across state and territory governments.

"The European Union is working to join Mercosur, its Latin American equivalent. That would create a common market of 790 million people."

Latin America

Latin America remains remarkably resilient, excluding Mexico. **Brazil** has defied gravity, with expansionary fiscal policy buoying demand and inflation.

The Bank of Brazil has asserted its independence. It is expected to keep policy restrictive for now.

I was sitting next to our Brazilian colleague as the threat of 50% tariffs came out. He shrugged and said it would just push Brazil closer to China and Russia and boost the approval ratings for the Brazilian president.

Rising debt and debt loads are a problem across the region, except for **Argentina.** (That is a sentence I never expected to write.) Fiscal austerity has brought down inflation, although it is still high. The central bank is easing while growth is poised to rebound, after two years of contraction. It is a primary driver of regional gains.

Chile and **Peru** are vulnerable to tariffs and trade tensions. Copper is their largest export. **Colombia** and Brazil are struggling with fiscal challenges.

Africa

The US withdrawal on trade and the US Agency for International Development (USAID) will have a profoundly negative effect on the region and the rest of the world via increased health risks. The war in Ukraine has stretched thin the sources of additional aid. Private sector donors are not large enough to take up the slack. Russia and China are eager to step in.

East Africa is outperforming the region – the threshold is low. Economic reforms have picked up as trade barriers have been reduced, but at the expense of political reforms.

West Africa is more mixed. **Nigeria** introduced reforms like depreciating the exchange rate and removing fuel subsidies. That initially led to higher inflation and unrest but should aid exports and eventually boost growth.

Southern Africa continues to underperform, with an overreliance on tourism. Corruption is undermining progress along with a spotty energy grid; the two are intertwined.

Rare earths? The Democratic Republic of the Congo and Rwanda have signed a peace deal brokered by the US administration, though skepticism is high on whether it will stick. The US is hoping to use the peace accord to gain access to rare earths in the region.

Separately, the African Growth and Opportunity Act (AGOA) expires in September. It covers a small amount of goods for the US. It is not clear it will be reapproved, which would further damage relations with countries in Africa.

MENA

The Middle East and North Africa (MENA) is the least exposed to tariffs due to its reliance on oil. Ongoing tensions between Israel, Iran and their neighbors have left the region a tinderbox. That has added to the risk premium attached to oil prices. Costs of traversing the Strait of Hormuz, which is a choke point for oil exports, have increased.

Bottom Line

I thought back on that day before our meetings began, and how my perspective has changed from atop the Cliffs of Moher. My family left the perch to make our way to Dublin, a major port city and the backdrop for our meetings.

Debate was intense and sometimes heated, much like our global relations. That did not stop us from coming together to break bread instead of ties at the end of each day.

I worry that US isolation could leave us on a cliff, separated from our trading partners. That could make our economy less flexible and susceptible to shocks. More bouts of inflation and the pain that triggers cannot be ruled out.

Our trading partners are not waiting for a full decoupling. They have decided to leave the ledge of the cliffs to set sail for more interconnected relationships in the waters below.

Still, I left the meeting with a sense of optimism. The only time the group has failed to meet since 1937 was during WWII; we already plan to meet again next year. Most countries do not want to break their ties with the US. In that sentiment is hope.

That which binds us is still greater than that which divides us. That seemed a fitting way to leave a country whose people and landscape have weathered the gale force winds of history and persevered. Thank you, Ireland and my friends, for reminding me of our shared history and resilience. Be kind; pay it forward.

Economic Forecast — July 2025

	2024	2025	2026	2024:4(A)	2025:1(A)	2025:2	2025:3	2025:4	2026:1	2026:2	2026:3	2026:4
National Outlook												
Chain Weight GDP[1]	2.8	1.4	1.7	2.4	-0.5	2.4	-0.2	0.8	2.2	2.6	2.4	2.0
Personal Consumption	2.8	1.9	1.8	4.0	0.5	1.4	0.1	1.4	2.2	2.4	2.3	2.1
Business Fixed Investment	3.6	1.8	-1.6	-3.0	10.3	0.9	-6.4	-3.7	-2.1	1.4	1.1	0.8
Residential Investment	4.2	-2.6	-0.5	5.5	-1.3	-6.2	-10.2	-0.7	-0.3	1.8	5.3	7.0
Inventory Investment (bil $ '17)	39	90	86	9	161	33	95	73	73	84	90	96
Net Exports (bil $ '17)	-1034	-1179	-983	-1053	-1359	-1131	-1142	-1082	-1019	-988	-965	-961
Exports	3.3	0.5	3.0	-0.2	0.4	-2.4	-3.3	2.0	3.9	6.0	7.1	4.1
Imports	5.3	4.4	-3.1	-1.9	38.0	-22.3	-1.2	-5.0	-4.0	0.8	2.6	2.6
Government Expenditures	3.4	1.7	0.1	3.1	-0.6	2.2	1.2	-0.8	0.0	0.1	0.0	-0.1
Federal	2.6	1.5	0.3	4.0	-4.6	2.1	2.4	-1.5	0.4	0.5	0.3	-0.2
State and Local	3.9	1.9	0.0	2.5	2.0	2.3	0.5	-0.4	-0.2	-0.1	-0.1	-0.1
Final Sales	2.7	0.3	2.2	3.3	-3.1	4.6	-1.2	1.2	2.2	2.4	2.3	1.9
Inflation												
GDP Deflator	2.4	3.3	3.0	2.3	3.8	2.7	6.1	4.1	2.9	1.9	1.6	1.5
CPI	3.0	3.0	3.0	3.0	3.8	1.6	4.5	4.2	3.2	2.3	2.0	1.2
Core CPI	3.4	3.3	3.1	3.4	3.5	2.0	5.1	4.2	3.0	2.5	1.9	1.6
Special Indicators												
Corporate Profits[2]	7.9	-0.5	1.1	6.9	6.3	1.9	-1.5	-8.0	-4.4	-1.6	4.1	6.7
Disposable Personal Income	2.7	1.4	3.2	2.5	2.5	3.1	-2.4	-0.1	8.6	3.2	3.2	3.9
Housing Starts (mil)	1.37	1.29	1.28	1.39	1.40	1.27	1.24	1.24	1.23	1.26	1.31	1.33
Civilian Unemployment Rate	4.0	4.3	4.6	4.2	4.1	4.2	4.4	4.5	4.6	4.6	4.6	4.6
Total Nonfarm Payrolls (thous)[3]	2081	1586	327	509.0	521.0	386.0	232.0	-8.0	43.0	75.0	86.0	122.0
Vehicle Sales												
Automobile Sales (mil)	3.0	2.7	2.5	3.1	3.0	2.7	2.6	2.4	2.4	2.4	2.6	2.6
Domestic	2.0	1.8	1.7	2.0	2.0	1.8	1.8	1.7	1.7	1.7	1.8	1.8
Imports	1.0	0.9	0.8	1.1	1.1	0.9	0.8	0.7	0.7	0.7	0.8	0.8
LtTrucks (mil)	12.8	12.8	12.3	13.5	13.4	13.4	12.3	12.0	12.0	12.2	12.4	12.7
Domestic	10.1	10.1	9.8	10.7	10.5	10.6	9.7	9.5	9.5	9.7	9.8	10.1
Imports	2.7	2.7	2.6	2.8	2.9	2.7	2.6	2.5	2.5	2.5	2.6	2.6
Combined Auto/Lt Truck	15.8	15.5	14.8	16.5	16.4	16.1	14.9	14.4	14.4	14.6	15.0	15.3
Heavy Truck Sales	0.5	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.5	0.5
Total Vehicles (mil)	16.3	15.9	15.3	17.0	16.9	16.5	15.2	14.8	14.8	15.0	15.5	15.8
Interest Rate/Yields												
Federal Funds	5.1	4.4	3.5	4.7	4.3	4.4	4.4	4.3	4.1	3.8	3.2	2.8
10 Year Treasury Note	4.2	4.4	4.1	4.3	4.5	4.4	4.5	4.4	4.3	4.1	4.0	3.9
Corporate Bond BAA	5.8	6.3	6.3	5.8	6.1	6.3	6.5	6.5	6.4	6.3	6.3	6.2
Exchange Rates												
Dollar/Euro	1.08	1.13	1.17	1.07	1.05	1.13	1.14	1.15	1.15	1.16	1.17	1.18
Yen/Dollar	151.5	144.4	138.5	152.5	152.4	144.5	142.0	141.0	140.0	139.0	138.0	137.0

[1] in 2024, GDP was $23.3 trillion in chain-weighted 2017 dollars.

[2] Corporate profits before tax with inventory valuation and capital consumption adjustments, quarterly data represents four-quarter percent change.

[3] Total nonfarm payrolls, quarterly data represents the difference in the average from the previous period. Annual data represents 4Q to 4Q change.

Quarterly data are seasonally adjusted at an annual rate. Unless otherwise specified, $ figures reflect adjustment for inflation. Total may not add up due to rounding.

kpmg.com/socialmedia